The pursuit of costs: litigation processes

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We review a taxpayer’s appeal against a First-tier Tribunal’s decision in relation to the costs of the appeal.

Key Points

What is the issue?

In many chambers of the First-tier Tribunal, it is simply not possible for a party to become liable to the other side’s costs. In tax cases, there is a very limited power to award costs, most notably if a party has acted unreasonably or if the case has been allocated to the complex case category.

What does it mean for me?

In the case of *Ulster Metal Refiners*, the company was successful in relation to 90% of input tax that HMRC had sought to block. However, the company's claim for costs was refused. It then appealed against the decision to the Upper Tribunal.

What can I take away?

The Upper Tribunal noted that the First-tier Tribunal declared that there was no overall winner, as no party got what they really wanted. The Upper Tribunal agreed with Ulster's argument that this meant that the First-tier Tribunal had failed to identify the winning party. As a result, it concluded that the First-tier Tribunal's decision on costs could not stand.

A fundamental aspect of the tribunals system is that a tribunal is meant to be a more accessible forum for achieving justice than the courts. This is partly reflected by the relative informality of the proceedings (although such informality is not always apparent in tax cases). It is further reflected by the fact that, in the vast majority of cases, the losing party will not end up having to pay the costs of the other side.

In fact, in many chambers of the First-tier Tribunal, it is simply not possible for a party to become liable to the other side's costs. In tax cases, there is a very limited power to award costs, most notably if either (or both):

- a party has acted unreasonably; or
- the case has been allocated to the complex case category.

It should generally be possible to avoid acting unreasonably and therefore falling within the first category ought not to occur. In relation to the second category, very few cases get allocated to the complex case category and therefore it is rarely an issue. However, even in those exceptional cases, the taxpayer has a 28 day period in which to opt out of the costs regime. As a result, even in complex cases, a taxpayer should be able to avoid being liable for any of HMRC's costs (assuming, of course, that the taxpayer does not act unreasonably).

This article considers the principles applying in those complex cases where the taxpayer has not opted out of the costs regime, as discussed by the Upper Tribunal in the case of *Ulster Metal Refiners Ltd v HMRC* [2024] UKUT 184 (TCC).

The facts of the case

The original case in the First-tier Tribunal concerned the recoverability of input tax by the company, Ulster Metal Refiners Ltd ('Ulster'). Ordinarily, leaving aside matters such as partial exemption and situations where input tax is blocked, a VAT-registered business will be able to recover the input tax it has paid on its purchases as a credit against its own VAT liability in relation to its own supplies. However, HMRC is entitled to withhold input tax which is associated with fraudulent transactions, if the taxpayer knew or should have known of the connection.

In the present case, HMRC had decided that a number of Ulster's input tax claims were connected with fraud and believed that the company either knew or should have known of the connection. Accordingly, this input tax was blocked. The company appealed against HMRC's decision to the First-tier Tribunal. The tribunal allocated the case to the complex case category and the company did not opt out of the costs regime.

In its appeal, the company was successful in relation to 90% of the input tax that HMRC had sought to block, so that only 10% of its input tax claim remained blocked. However, the First-tier Tribunal made considerable criticisms of the conduct of the company's director, whose credibility was often doubted and who was found by the tribunal to have conducted the litigation as if it were 'a misguided game of forensic hide and seek', which is in stark contrast to the obligations on the parties to further the 'overriding objective' of fairness and justice.

The First-tier Tribunal took a holistic approach to the case and said that any award of costs should be 'appropriately reflective of all the circumstances including … the strong public interest in discouragement of dishonest evidence to obtain public funds'. It concluded that it was 'not going too far, and is fair and just, to deprive [Ulster] (despite its success in relation to a large proportion of the deals in issue) of the ability to recover any of its costs from HMRC'.

As a result, the company's claim for costs was refused. However, the company then appealed against the decision to the Upper Tribunal.

The Upper Tribunal's decision

The case came before Mr Justice Peter Roth and Deputy Upper Tribunal Judge Anne Redston.

The Upper Tribunal first noted that, in the High Court and County Court, there is a presumption that the winner will be entitled to its costs. That presumption is embedded in the procedure rules that govern the civil courts and is not found in the rules operating in the Tax Chamber of the First-tier Tribunal.

Nevertheless, the Upper Tribunal concluded that the concept that the winner should be entitled to its costs should be the starting point in the First-tier Tribunal as well, even without an express rule to that effect. (Given the fact that it is only the most complex of cases where costs can be in issue and given the fact that the taxpayer has the right to opt out of the costs regime, I do not think that that is an unreasonable approach to take.)

As to identifying the winning party, the Upper Tribunal said that this should be approached by the application of common sense. In this case, the appellant (winning 90% of the case in the First-tier Tribunal) should be treated as the winning party.

The Upper Tribunal then referred to other case law which stated that there is no general rule that a finding of dishonest conduct should replace the usual starting point.

Applying those principles to the case, the Upper Tribunal acknowledged that the First-tier Tribunal had correctly:

a) identified the general rule, being that the unsuccessful party should pay the winner’s costs;

b) recognised that Ulster was the arithmetical winner (having won 90% of the amount at stake); and

c) when it made its decision, it did so by asking whether it was ‘fair and just to *deprive*’ (emphasis added) Ulster a large proportion of its costs.

However, the Upper Tribunal also noted that the First-tier Tribunal proceeded to declare that there was no overall winner, as no party got what they really wanted. The Upper Tribunal agreed with Ulster’s argument that this meant that the First-tier Tribunal had not properly applied the first step in the process – because it had failed

to identify the winning party. As a result, the Upper Tribunal concluded that the First-tier Tribunal's decision on costs could not stand. Accordingly, the Upper Tribunal proceeded to remake the decision.

In doing so, the Upper Tribunal took the following approach:

1. The company was the overall winner and therefore, *prima facie*, entitled to its costs.
2. As the company was only 90% successful, those costs should be reduced by 10%.
3. Furthermore, to reflect the fact that HMRC was partially successful (to the tune of 10%), a contribution to represent HMRC's costs in relation to this 10% was also to be deducted. This contribution was taken, using a broad brush approximation, to be 5% of the company's overall costs. That left the company with an entitlement to 85% of its costs.
4. Finally, a further reduction was ordered to reflect the company's inappropriate conduct. However, that further reduction should be limited to reflecting those additional costs incurred as a result of that conduct, rather than a complete denial of the company's costs award. As a result, the costs award was reduced to 40% of the company's overall costs.

Commentary

It cannot be doubted that the principles set out by the Upper Tribunal are the correct ones. However, I do have a couple of observations about the decision.

First, I am not sure that the First-tier Tribunal really departed from the correct approach. The thrust of its decision was that, ordinarily, the winner should be entitled to its costs but this was ultimately a discretionary matter. Factors such as the company's conduct and the fact that the company's success (though substantial) was not absolute led the First-tier Tribunal to the conclusion that this was a case where the company should be deprived of what it would otherwise have been entitled to receive.

There again, the use of the phrase 'the substantive appeal did [not] produce a clear winner' did raise the question as to whether the correct approach had been followed. The Upper Tribunal considered that to be fatal to the First-tier Tribunal's

decision and that is why it set aside the decision.

The Upper Tribunal has also taken a different line from the First-tier Tribunal in respect of how to respond to the dishonest conduct of the company's director. The First-tier Tribunal considered that that conduct was so serious that it merited a significant reduction (or elimination) of the costs award otherwise payable to the company. As noted above, the Upper Tribunal considered that dishonest conduct should not generally replace the usual starting point. But it is difficult to see that the First-tier Tribunal made this mistake – on my reading, the First-tier Tribunal had recognised the correct starting point but then used the findings of dishonesty as a reason to deny the company its costs.

However, the Upper Tribunal also referred to High Court authority which said that, when looking at the wider circumstances of the case and the factors that might lead to reduction of a costs award:

'[E]ven when what is being considered is conduct, rather than the loss of one or more issues, it will generally not be just to deprive a successful party of part of its costs because of conduct which has had no adverse impact on the incidence of costs … [I]f what is complained about has had no impact on costs, it will require cogent reasons to justify depriving a successful party of part of its costs on the basis of the complaint.'

It will be noted that this authority is subject to qualifications (for example, the use of the word 'generally') and therefore does not set down an absolute rule. If there are cogent reasons to deny a party all of its costs as a result of poor conduct, then there is no principle that prevents such an outcome.

In my view, poor litigation tactics, such as being obstructive, are not sufficient to justify a departure from the general rule. However, if a party's whole attitude to the litigation process is tainted by dishonesty, I would not rule out another tribunal taking a stricter line.

Accordingly, had the First-tier Tribunal not stumbled on the need to clearly identify the overall winner, I doubt that the outright denial of the company's costs would have been susceptible to an appeal. As a result, I think that the company was lucky to end up recovering 40% of its costs.

What to do next

The case also serves as a reminder that litigation should not be treated as a game. Parties in the tribunal are under a positive duty to assist the First-tier Tribunal in reaching a fair and just outcome. That obligation should be observed, even without worrying about the adverse costs consequences of non-compliance. However, breaches can actually lead to problems in relation to costs (either, as in this case, a reduction in a costs award that would otherwise be made in favour of a party, or an award against that party for unreasonable conduct – something that can happen even in non-complex cases).

Postscript to my article in July: In my article on the IR35 case (*HMRC v RALC Consulting Ltd*), in the July 2024 issue of *Tax Adviser*, I expressed surprise that HMRC was pursuing an allegation of careless conduct in respect of the earlier years under review. I said that I could not recall carelessness being alleged in any other IR35 case, as it strikes me as almost impossible to prove. I have since been reminded that HMRC did allege carelessness in the IR35 case of *PAYA Ltd v HMRC* [2019] UKFTT 583 (TC). On that point, it lost.